January 2007
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Namibia: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Namibia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Namibia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 14, 2006, with the officials of Namibia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 13, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 5, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Namibia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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NAMIBIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the
2006 Consultation with Namibia

Approved by Thomas Krueger and Anthony R. Boote

December 13, 2006

- Streamlined 2006 Article IV consultation discussions were held in Windhoek, November 6-14, 2006. Staff met with Prime Minister Angula, Finance Minister Kuugongelwa-Amadhila; Bank of Namibia (BoN) Governor Alweendo; Members of Parliament; representatives of the private sector, NGOs, and labor unions; economic think tanks; and members of the diplomatic community.
- The staff team comprised Mr. Mueller (head), Mr. Dwight and Mr. Miyajima (all AFR). The mission was joined by Mr. Medas (FAD) to assess the parastatals sector and overlapped with an MCM diagnostic mission that provided guidance on the implementation of the 2005 FSAP recommendations, including on banking supervision and liquidity management.
- The Executive Board concluded the 2005 Article IV consultation on March 24, 2006. Directors welcomed Namibia's overall prudent macroeconomic policies. They welcomed recent progress on fiscal consolidation and reiterated the importance of realistic budgets and the need for more sustained efforts to shore up revenues and reprioritize spending. Directors agreed the peg of the Namibia dollar to the South African rand had served the country well but stressed the need to ensure adequate levels of international reserves. With a view to enhancing Namibia's growth potential, Directors underscored that Namibia should implement structural reforms to raise skill levels, enhance the flexibility of labor markets, and improve the business climate.
- The authorities have been increasingly willing to follow Fund policy advice, in particular for the fiscal and financial sectors, where Namibia has benefited from extensive technical assistance (TA), as well as a fiscal ROSC and an FSAP.
- Namibia fixes its currency at par to the South African rand, which is also legal tender.
- Namibia has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 and maintains an exchange system free of restrictions on the making of transfers and payments of current account transactions.

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EXECUTIVE SUMMARY

Background: With generally prudent macroeconomic policies, Namibia has enjoyed robust growth, moderate inflation, and strong external surpluses. More progress is needed on broadening Namibia's economic base, raising its long-term growth potential, and safeguarding future competitiveness. There is also a need to address Namibia's high rates of poverty, unemployment, and HIV/AIDS infection.

Key Policy Issues: The 2006 Article IV consultation discussions were streamlined with a focus on private sector development, the level of international reserves, and medium-term fiscal policy.

- *Private Sector Development*: The authorities are well along in implementing their HIV/AIDS strategy, have begun education reform, and created an Anti-Corruption Commission. Although changes in the real effective exchange rate (REER), productivity, and business indicators give a mixed view, they do not suggest immediate concerns about competitiveness. Nonetheless, further steps could be taken to broaden the economic base and boost the flexibility of the economy. These include facilitating skills transfer from abroad, reducing labor costs, streamlining business requirements, and strengthening the financial system. Such actions should be underpinned by a prudent macroeconomic policy mix.

- *International Reserves*: The Namibia dollar is pegged to the South African rand. While the current level of the exchange rate appears broadly appropriate, reserves are low and external surpluses are projected to decline significantly in the medium term. Staff recommended market-based measures to boost reserves and create domestic investment opportunities but advised against regulatory steps to stem capital outflows.

- *Fiscal Policy*: After two years of consolidation, the underlying fiscal policy stance loosened in 2006/07. A tighter stance would have been warranted in light of projected medium-term fiscal pressures emanating from a projected decline in customs union revenues and increased spending on Namibia's development needs. Staff recommended the authorities develop a strategy to enhance tax administration and reorient spending from wages and subsidies towards health, education, poverty reduction, and infrastructure investment. The authorities have passed legislation that, if implemented well, should improve the governance and performance of parastatals.

I. BACKGROUND

1. **Supported by generally prudent macroeconomic policies, Namibia has enjoyed robust growth, moderate inflation, and strong external surpluses** (Figure 1). Although other sectors have shown steady growth, reliance on minerals has made economic performance volatile. Little progress has been made in broadening the country's economic base and raising its long-term growth potential. In addition, poverty and unemployment are widespread, and a high rate of HIV/AIDS infection undermines investment in human capital.

Text Table 1. Namibia: Macroeconomic Indicators

	2004	2005	2006 Proj.	2006 SSA average[1] Proj.
Real GDP growth (percent)	6.6	4.2	4.6	4.8
End-of-period inflation (percent)	4.3	3.5	5.7	...
Average inflation (percent)	4.1	2.3	5.0	11.2
Interest rate on three-month treasury bill (percent)	7.5	7.0	…	…
Broad money growth (percent)	16.2	9.7	20.0	21.4
Foreign reserves (months of imports)	1.7	1.4	1.6	5.9
(reserves to short-term debt)	0.5	0.6	0.7	…
Overall fiscal balance including grants (percent of GDP)[2]	-3.4	-0.7	0.1	4.5
Government revenue (percent of GDP)[2]	31.0	33.0	36.0	26.4
Current account balance including grants (percent of GDP)	9.5	7.2	13.9	0.8
Terms of trade (percent change)	-1.0	8.7	5.4	10.8
Period-average real effective exchange rate (percentage change)	7.0	0.7	-1.2	…
Inward foreign direct investment (US$ millions)	226.2	347.8	371.0	…

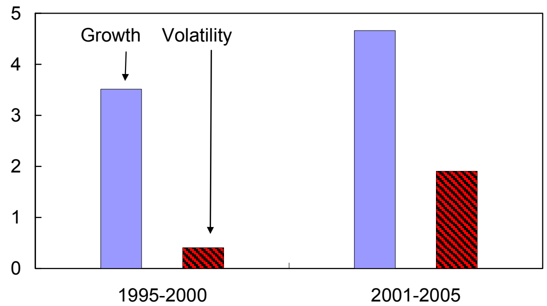
Source: WEO/WETA database.
[1] Average for sub-Saharan African countries.
[2] For Namibia, data are on fiscal-year basis (April 1-March 31).

2. **Macroeconomic performance has held strong, helped by a recovery of diamond production in 2006** (Figure 2). Rising oil prices and interest rates have not yet noticeably affected activity. Though rising, inflation is expected to remain moderate. The current account has a comfortable surplus, thanks to record diamond exports and a surge in customs union (SACU) receipts. However, continued outflows of capital to South African financial markets have kept international reserves relatively low. With tax collections buoyant, the 2005/06 fiscal deficit fell to ¾ percent of GDP, though spending on wages and subsidies exceeded budget ceilings. Consistent with the peg to the rand, the BoN has matched recent interest rate increases by the South African Reserve Bank, lifting rates by 2 percentage points in 2006.

Figure 1. Namibia: Major Macroeconomic Challenges

Namibia's recent growth has been volatile ...

Real GDP Growth and Volatility
(Percent)



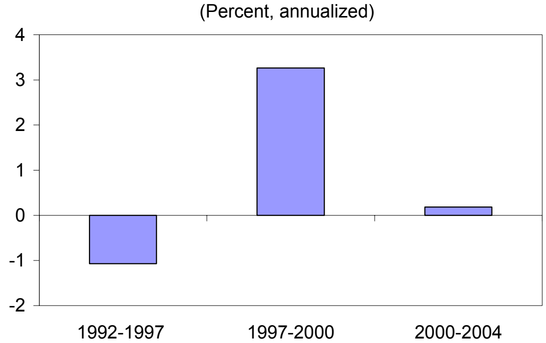
... but has exceeded that of most neighbors.

Real GDP Growth
(Percent)

	2001	2002	2003	2004	2005	2001–05 Average
SSA average (unweighted)	6.1	4.0	3.7	5.5	4.4	4.7
SACU average (unweighted)	3.0	4.5	3.7	4.4	3.7	3.8
Botswana	4.9	5.6	6.3	6.0	6.2	5.8
Lesotho	3.3	3.6	3.2	2.7	1.3	2.8
Namibia	**2.4**	**6.7**	**3.5**	**6.6**	**4.2**	**4.7**
South Africa	2.7	3.7	3.0	4.5	4.9	3.7
Swaziland	1.6	2.9	2.4	2.1	1.9	2.2

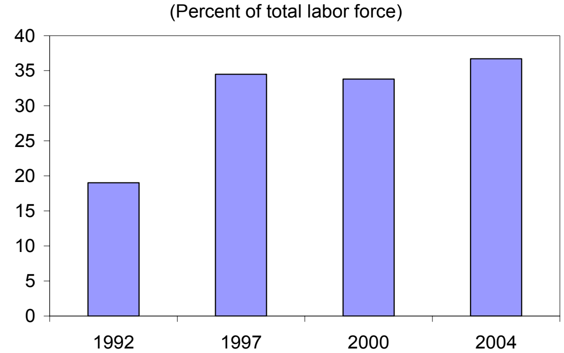
Growth has not been sufficient to create jobs in recent years ...

Average Growth of Employment
(Percent, annualized)



... keeping unemployment high ...

Unemployment Rate
(Percent of total labor force)



... and poverty is still widespread ...

Households Living in Poverty [1]
(Percent of total households)

	1993/94	2003/04
Severely poor	9	4
Poor	38	28

... while the rate of HIV/AIDS infection is among the highest in Africa.

HIV/AIDS Prevalence, 2005
(Percentage of adult population, ages 15-49)

Botswana	24.1
Lesotho	23.2
Namibia	**19.6**
South Africa	18.8
Swaziland	33.4
Sub-Saharan Africa	6.1

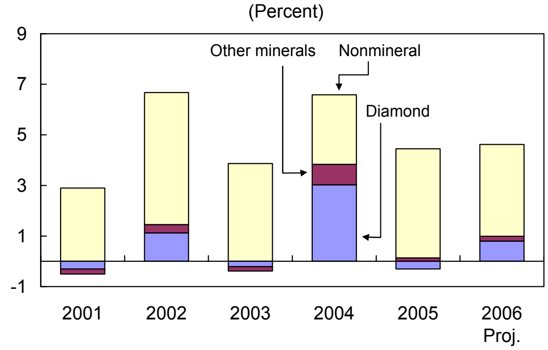
Sources: Namibian authorities; UNAIDS report 2006; Namibian Household Survey 2004; and Fund staff estimates.

[1] The severely poor and poor are defined as those who spend more than 80 percent and 60 percent, respectively, of total income on food.

Figure 2. Namibia: Selected Economic Indicators

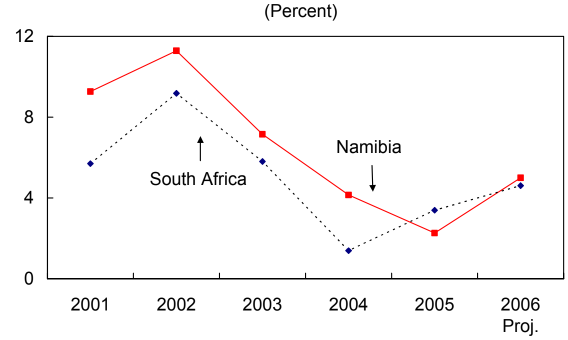
Namibia's growth has been strong, with volatility driven by the diamond sector.

Contributions to Real GDP Growth
(Percent)



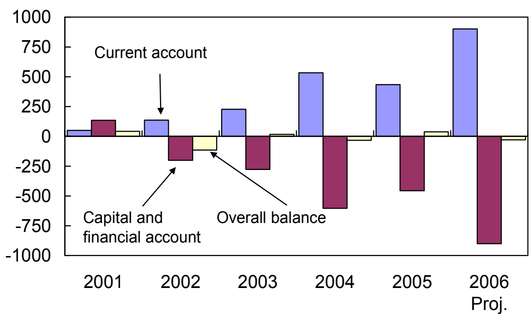
Inflation has been moderate, following trends in South Africa.

Average Inflation
(Percent)



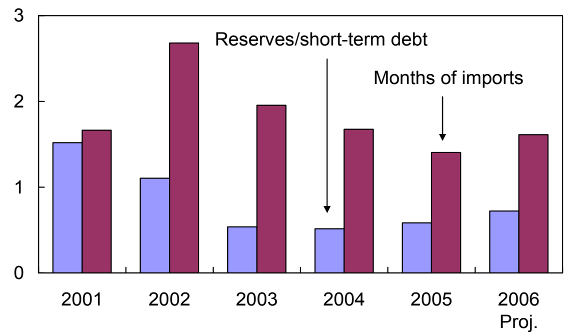
Large current account surpluses have been offset by capital outflows ...

Balance of Payments
(Millions of US dollars)



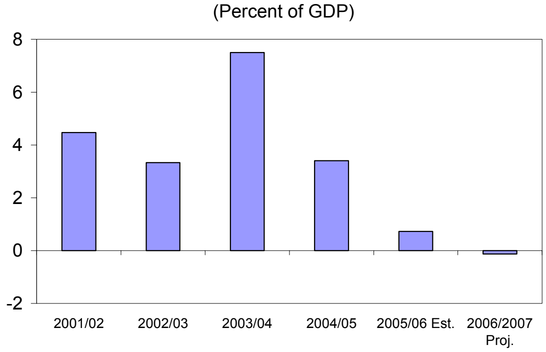
... which have in recent years lowered international reserves.

International Reserves
(Relative to months of imports and short-term debt)



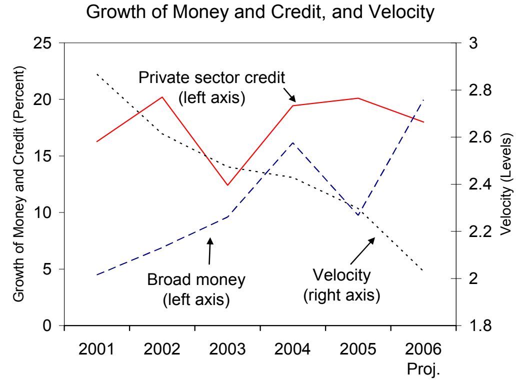
After peaking in 2003/04, the government deficit has declined ...

Overall Fiscal Deficit, Including Grants
(Percent of GDP)



... and financial intermediation has continued to strengthen.

Growth of Money and Credit, and Velocity



Sources: Namibian authorities; and Fund staff estimates and projections.

II. Policy Discussions

A. Overview

3. **The 2006 Article IV consultation was streamlined**. Building on the detailed analysis of the 2005 Article IV mission, this year's discussions focused on: (i) private sector development, emphasizing competitiveness and financial sector issues; (ii) the level of international reserves; and (iii) medium-term fiscal policy.

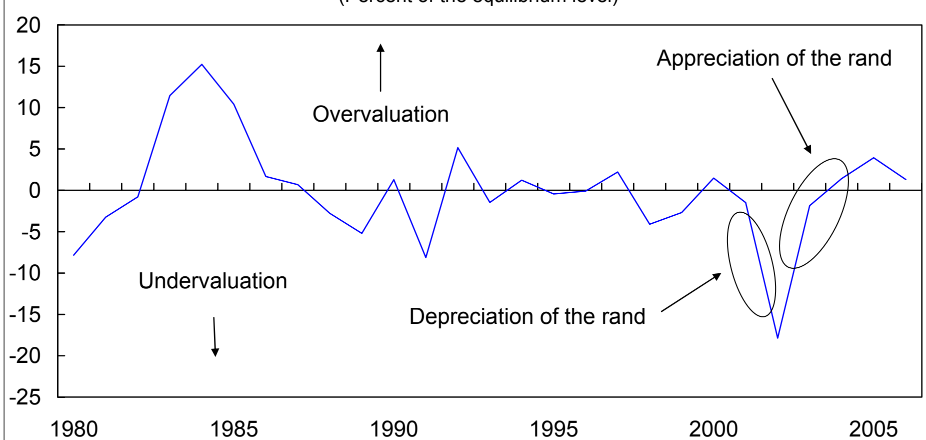
4. **The authorities saw the streamlined format, as well as Fitch's recent confirmation of Namibia's investment grade rating, as acknowledgement that their macroeconomic policies are prudent**. Nonetheless, they emphasized Namibia's major developmental needs and reiterated their concern that Namibia's classification as a middle-income country hinders their ability to tap concessional financing.

B. Private Sector Development

5. **The authorities have begun reforms that should help raise Namibia's growth potential**. Particularly noteworthy are the recent launching of education reform—to narrow the skills mismatch in the economy—and the strong implementation of the HIV/AIDS strategy, which envisages universal coverage of antiretroviral treatment by 2010. The newly created Anti-Corruption Commission (ACC) represents a milestone toward improved governance; however, the mission stressed that the ACC would need adequate funding if it is to fulfill its mandate.

6. **Indicators provide a mixed view of competitiveness, though the indicators and the current level of the REER do not suggest cause for immediate concerns** (Box 1). Staff estimates of the equilibrium REER suggest that a small overvaluation in 2005 was largely reversed in 2006 as the exchange rate depreciated. Nonetheless, there are challenges to Namibia's future competitiveness. In particular, its traditionally strong current account surplus is projected to decline drastically over the medium term, as SACU revenues are expected to fall and mineral exports to plateau.

Text Figure 1. Namibia: Real Effective Exchange Rate: Deviations from the Equilibrium Level, 1980-2006 [1]
(Percent of the equilibrium level)



[1] Equilibrium level estimated through single-country regressions using standard fundamentals. While consistent with the results from panel estimations for a large sample of African countries, the small data size and concerns about data quality before independence in 1990 warrant cautious interpretation. The equilibrium level in period *t* is a 3-year average for *t-1*, *t*, and *t+1*.

Box 1. Namibia's Competitiveness

Traditional measures, such as the REER, do not suggest that Namibia has a competitiveness problem (Figure 3). However, Namibia's REER has remained relatively unchanged since independence while South Africa's has depreciated. This is partly because average annual inflation has been about 1 percent higher in Namibia than in South Africa (although the inflation rates have recently converged). Also, Namibia's peg to the rand and the large trade weight of South Africa dampen movements in Namibia's REER.

Though labor productivity appears to have grown more in Namibia than in its neighbors during 2000-05, productivity levels are still generally below South Africa's. In mining and manufacturing, where productivity has risen rapidly, Namibia compares favorably with South Africa, but productivity growth has lagged in the service sectors. For example, the productivity level in wholesale trade is estimated to be 40 percent lower in Namibia than in South Africa, and productivity in government services is 30 percent lower. Moreover, the level of government productivity has been falling relative to South Africa. This may reflect Namibia's large civil service.

Other indicators give a mixed view of Namibia's competitiveness. Since independence, Namibia's terms of trade have been volatile though with no clear trend. The trade deficit has averaged 5 percent of GDP and the current account surplus 4½ percent. Though they are also volatile, these figures do not show any worsening trend. In contrast, Namibia's share of world trade has steadily fallen. Qualitative indices (see below) also suggest room to improve competitiveness.

Global Competitiveness Index 2006
(Out of 125 countries, best=1, worst=125)

Namibia scores well on strength of institutions and macroeconomic policies but low on education and innovation.

Overall ranking of Namibia	84
Subcategories:	
Institution	18
Infrastructure	43
Macroeconomy	43
Technological readiness	78
Market efficiency	79
Business sophistication	83
Innovation	88
Higher education and training	105
Health and primary education	111

Source: World Economic Forum.

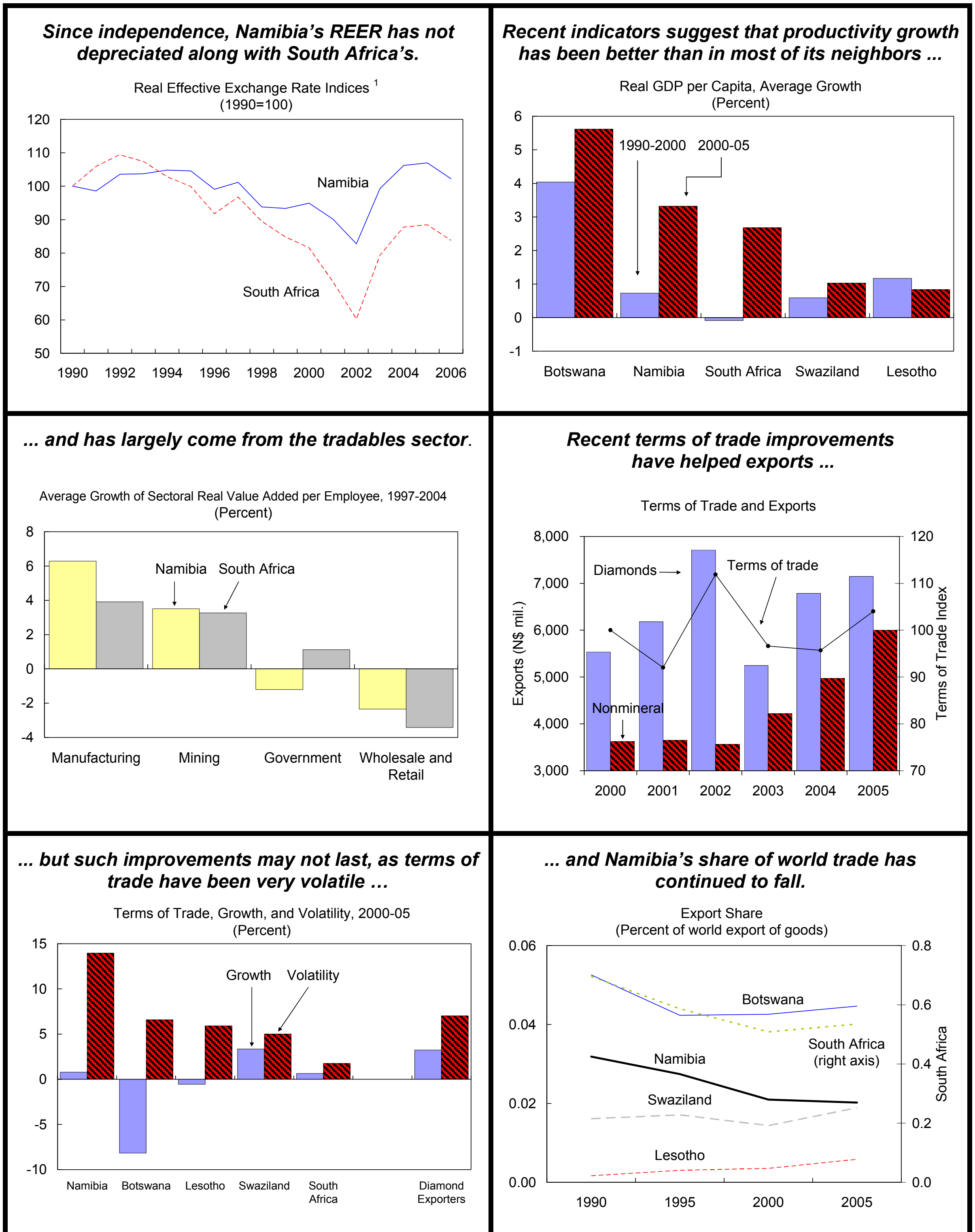
Doing Business Indicators 2006
(Out of 175 countries, best=1, worst=175)

Namibia ranks well on licensing and taxes but low on registering property and costs for cross-border trade.

Overall ranking of Namibia	42
Subcategories:	
Dealing with licenses	19
Paying taxes	28
Getting credit	33
Closing a business	42
Employing workers	44
Protecting investors	60
Enforcing contracts	64
Starting a business	86
Registering property	127
Trading across borders	144

Source: World Bank.

Figure 3. Namibia: Competitiveness



Sources: IFS, WEO, Namibian Authorities, and Fund staff calculations.

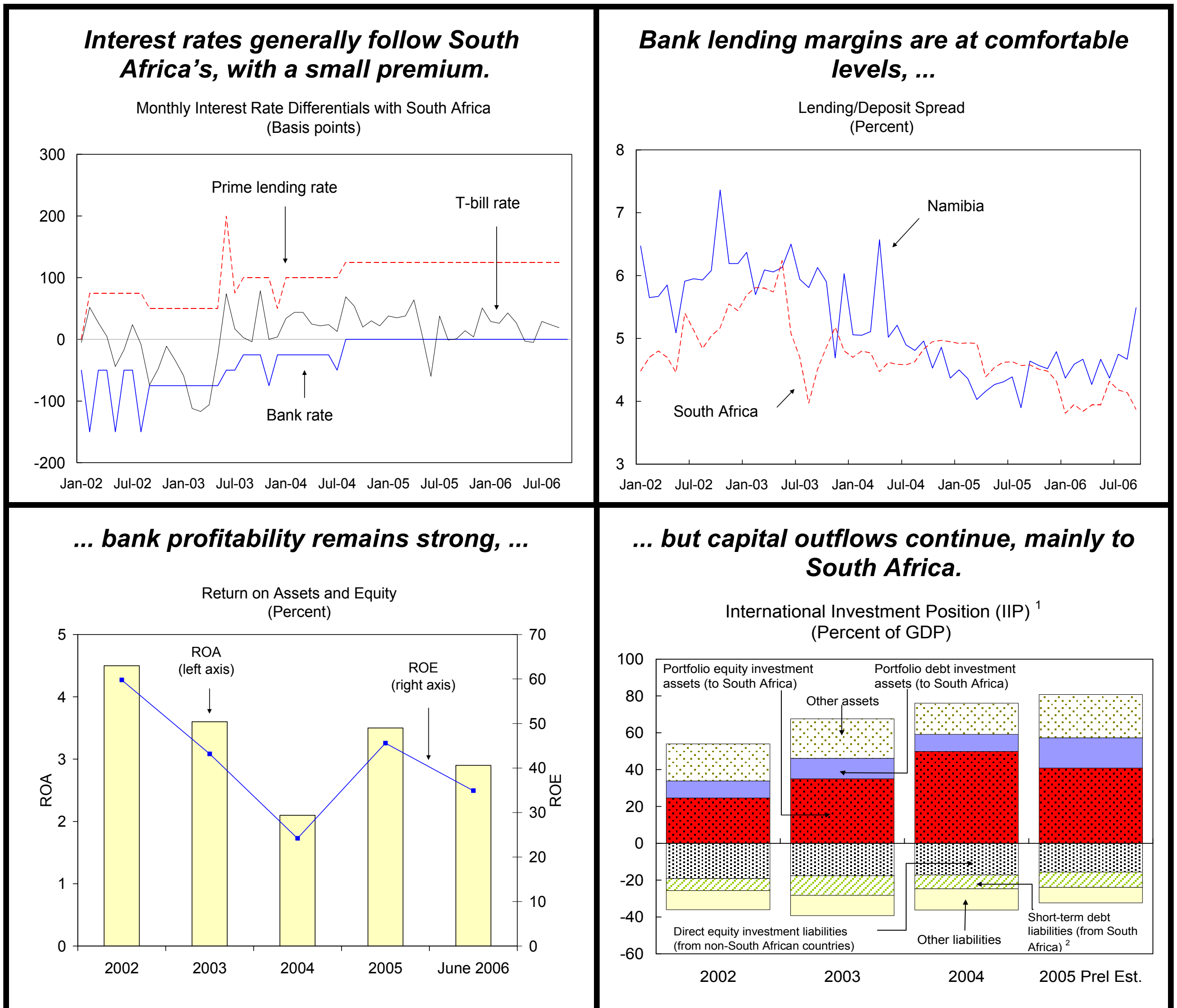
[1] Values for September and October 2006 are estimated from the nominal exchange rates, and for the remainder of 2006 values are assumed to be constant.

7. **The authorities concurred with the need to boost private sector activity**. They plan to continue their dialogue with the business community to identify and remove obstacles to private sector activity, such as with respect to the streamlining of business licensing and property registration. The mission suggested that measures be taken in two key areas. First, there is a need to facilitate the entry of skilled foreign workers to bridge the skills gap until education reform produces enough qualified local workers. The authorities recognized that transferring skills from abroad is important but stressed their intention to balance the entry of skilled workers against the objective of developing local capacity and improving the employability of Namibian workers. Second, Namibia should keep labor markets flexible and labor costs in check. The authorities' decision not to implement the 2004 amendments to the Labor Law, which would have raised labor costs, is therefore commendable, but it is not clear whether a revision of these amendments, to be submitted to parliament in early 2007, will allay concerns about excessive vacation days and sufficiently address the cumbersome procedures for terminating nonperforming employees.

8. **Further modernizing the financial system would also help develop the private sector** (Figure 4). Little has been done to broaden the reach of the financial system to rural and low-income customers. There is a particular need for affordable financial products for those customers and a reduction in the high banking charges. To address these problems, the authorities are consulting with the industry on developing a financial sector charter. Aside from accessibility, the charter aims to enhance the role of formerly disadvantaged groups, similar to efforts undertaken in South Africa.

9. **The regulatory and supervisory framework for the financial sector is being upgraded**. On banking supervision, the BoN has made great strides toward complying with the Basel Core Principles. In particular, it has clarified the methodology for measuring market and country risks and has begun implementing consolidated and risk-based supervision, as the 2005 FSAP recommended. There has been less progress on supervision of nonbank financial institutions (NBFIs). The authorities stressed that overhauling the regulatory and supervisory framework for NBFIs and reorganizing their supervisory agency, NAMFISA, represented daunting tasks but concurred that remaining deficiencies needed to be addressed expeditiously. The mission also urged speedy adoption of the NAMFISA Act, which would close gaps in the legislative framework for nonbank supervision. Finally, current indicators suggest that the banking system remains generally sound and profitable. Against the backdrop of the continued strong growth in credit to the private sector, the mission recommended that the authorities further explore the underlying causes for the more recent rise in nonperforming loans as well as monitor their evolution going forward.

Figure 4. Namibia: Financial Sector Developments



Sources: Bank of Namibia; NAMFISA; South African Reserve Bank; IFS; and Fund staff calculations.
[1] Based on Namibian IIP data, except for direct investment liabilities with South Africa, which are based on South African IIP data. This reflects the status of the current reconciliation exercise.
[2] In 2005, 63 percent of total short-term debt liabilities with South Africa was owed by commercial banks.

Text Table 2. Namibia: Financial Sector Indicators
(Percent)

	2001	2002	2003	2004	2005	June 2006
Capital adequacy						
Capital to assets	8.7	7.5	8.3	8.8	7.8	8.3
Regulatory capital to risk-weighted assets	15.5	14.1	14.8	15.4	14.6	14.8
Regulatory tier I capital to risk-weighted assets	12.4	11.0	12.2	12.7	11.2	11.8
Nonperforming loans (net of provisions) to capital [1]	10.9	11.6	14.3	1.1	3.0	8.2
Asset quality						
Large exposure to capital	182.1	207.2	190.2	181.2	182.8	165.7
Nonperforming loans to total gross loans [1]	3.4	3.5	3.9	2.4	2.3	2.9
Earnings and profitability						
Return on assets	4.6	4.5	3.6	2.1	3.5	2.9
Return on equity	52.6	59.8	43.2	24.2	45.6	34.9
Interest margin to gross income	49.0	53.0	51.3	57.0	50.7	51.4
Noninterest expenses to gross income	51.3	49.3	58.1	69.2	55.8	56.3
Liquidity						
Liquid assets to total assets	9.6	9.4	11.0	10.4	9.5	9.5
Exposure to foreign exchange risk						
Net open position in foreign exchange to capital	0.4	0.1	0.0	0.5	1.4	0.5
Foreign currency-denominated loans to total loans	5.4	5.0	3.0	1.9	0.7	0.6
Foreign currency-denominated liabilities to total liabilities	4.6	5.2	4.5	2.0	1.1	1.7

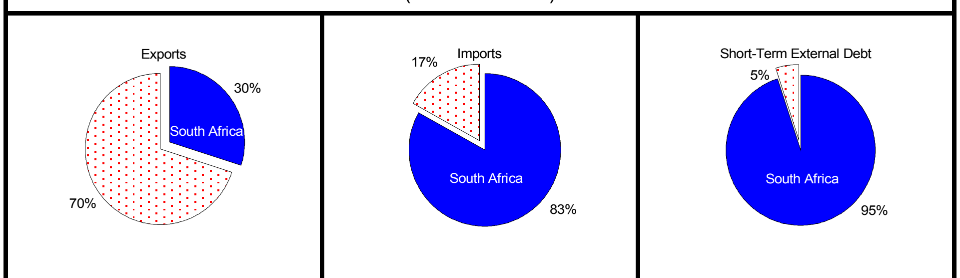
Sources: Bank of Namibia; and Fund staff estimates.

[1] The improvement in the NPLs ratio in 2004 was due to refocused loan collection efforts, reclassifications of loans, and write-offs by one commercial bank. The slight deterioration in the NPLs ratio in the second quarter of 2006 stemmed from commercial bank loan exposure to fishery and mining companies.

C. International Reserves

10. **The authorities are firmly committed to the exchange rate peg to the South African rand and further economic integration in southern Africa**. This could include the possibility of a monetary union under the Common Monetary Area (CMA).[1] The peg is consistent with Namibia's close trade and financial links with South Africa and enjoys strong public confidence and support.

Text Figure 2. Namibia: Trade and Financial Ties to South Africa, 2005
(Percent of total)



Source: Namibian Central Bureau of Statistics.

[1] IMF Country Report No 06/153, Chapter IV, discusses the pros and cons of Namibia joining a monetary union.

11. **The mission recommended the authorities take steps to increase reserves**. While reserves are twice the monetary base, they are uncomfortably low relative to imports and short-term debt. More reserves would help insure against adverse shocks to trade and capital flows. However, limited domestic investment opportunities have left private investors (particularly NBFIs) with little choice but to channel their assets to the more sophisticated South African financial markets. The 2005 FSAP suggested that creating greater domestic investment opportunities would be key to building reserves and attracting capital.

12. **The mission advocated several specific market-based strategies to help strengthen reserves**. These include promoting asset securitization, open market purchases of foreign exchange, and, if need be, creating a positive interest rate differential vis-à-vis South Africa. It also supported the authorities' decision to borrow internationally—the BoN contracted a syndicated one-year loan of US$50 million in August 2006 to establish a market presence—which benefited gross reserves; however, the mission emphasized that future borrowing should have longer maturities to reduce rollover risk. It strongly advised against regulatory measures to stem capital outflows, such as requiring Namibian NBFIs to invest in domestic assets which is unlikely to be effective, could carry higher risk, and undermine NBFIs' soundness.

13. **The authorities concurred with the need to build reserves and generally welcomed the mission's proposals**. They stated that their efforts to strengthen liquidity management, along the lines of Fund TA, should help them purchase foreign exchange in the market. They also plan to discuss with financial institutions means to create domestic investment opportunities, including the securitization of assets, such as mortgages. However, they did not exclude taking regulatory steps to keep savings within the country to help finance its development needs.

D. Fiscal Policy

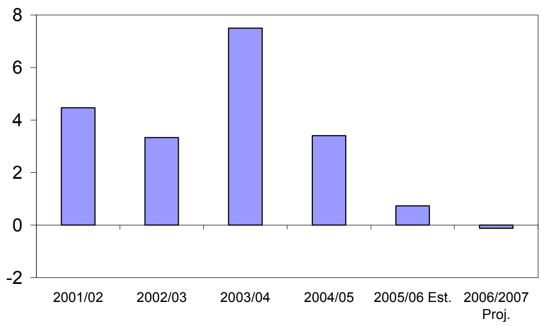
14. **After substantial fiscal consolidation in the two preceding years, the authorities loosened their underlying fiscal policy stance in 2006/07** (Figure 5). Namibia will receive a temporary windfall in SACU revenues of about 5 percent of GDP this fiscal year due to buoyant imports (resulting from past appreciation of the rand) and residual distributions from the transition to a new SACU revenue-sharing formula.[2] A supplementary budget submitted during the mission devotes a portion of this windfall to deficit reduction, resulting in a small budget surplus for 2006/07. However, the bulk of the windfall is earmarked for additional spending. In light of projected medium-term fiscal pressures, the mission noted that it would have been desirable to devote more of these one-off receipts to reducing public debt, as was done with receipts from the partial privatization of the mobile phone service provider MTC. While public debt is projected to fall to around 26 percent of GDP by 2007/08—within striking distance of the authorities' long-run fiscal rule target of 25 percent of GDP—it is expected to rise again over the medium term. This rise reflects the projected sharp drop in SACU receipts—to some extent related to trade liberalization—and Namibia's substantial development needs which require increased outlays for health, education, poverty reduction, and infrastructure.

[2] The appreciation of the rand was reversed in 2006 and the residual payments will be phased out in 2007/08.

Figure 5. Namibia: Fiscal Issues

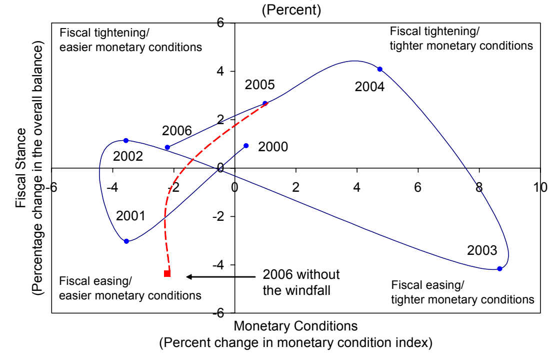
Namibia's budget position has improved significantly in recent years ....

Overall Fiscal Deficit, Including Grants
(Percent of GDP)



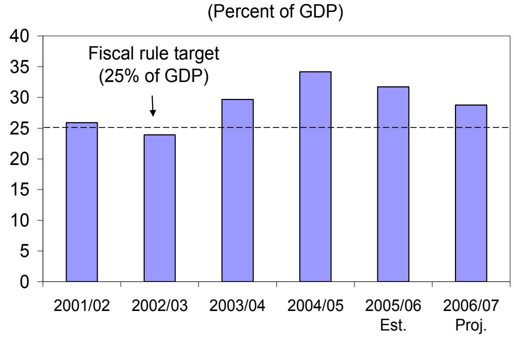
... coinciding with a tightening of monetary conditions.

Macroeconomic Policy Environment [1]
(Percent)



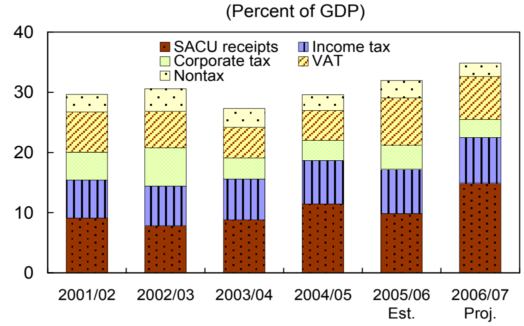
Government debt has declined since its peak in 2004/05, though remaining above target.

Public debt
(Percent of GDP)



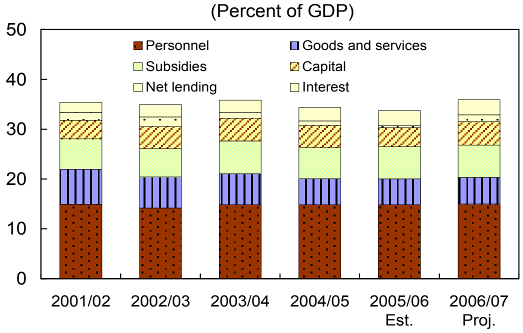
The deficit reduction was due largely to temporary increases in SACU receipts.

Composition of Revenues
(Percent of GDP)



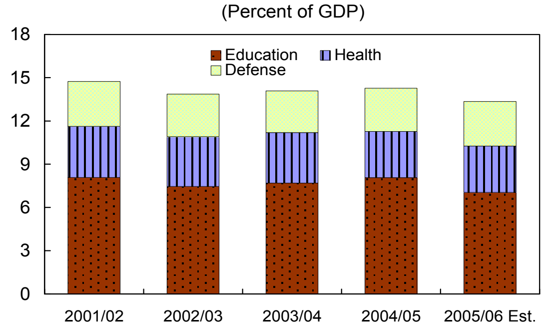
Nonetheless, the government has not reduced spending, particularly the wage bill, subsidies, ...

Composition of Expenditures
(Percent of GDP)



... and defense outlays. More could be done to reorient spending toward priority sectors.

Spending on Education, Health, and Defense
(Percent of GDP)



Sources: Namibian authorities and Fund staff estimates.

[1] The fiscal stance is represented by changes in the overall balance (including grants) as a percent of GDP, while monetary conditions are measured by an index of the weighted average of the real policy interest rate and real effective exchange rate, the weights being 50:50. The windfall in SACU receipts is estimated as the difference (as a percent of GDP) between the projected value for 2006 and the trend for 2000-05.

Text Table 3. Namibia: Central Government Operations
(Percent of GDP) [1]

	2005/06	2006/07		2007/08	2008/09	2009/10	2010/11	2011/12
	Est.	Suppl. Budget	Staff Proj.	Staff Proj.	Staff Proj.	Staff Proj.	Staff Proj.	Staff Proj.
Revenue and Grants	33.0	36.3	36.0	34.7	31.1	31.1	31.1	31.1
Of which: SACU receipts	9.9	15.2	14.9	12.9	8.6	8.2	7.8	7.4
Expenditures	33.7	36.2	35.9	35.5	34.8	34.3	33.5	32.8
Of which: wages	14.9	14.4	15.0	15.1	14.9	14.7	14.4	14.2
goods and services	5.1	5.5	5.4	5.3	5.2	5.1	4.9	4.8
subsidies	6.4	6.4	6.5	6.4	6.2	6.1	5.9	5.8
capital spending	3.9	5.4	4.7	4.8	4.9	5.0	5.0	5.0
net lending	0.4	1.4	1.4	1.3	1.1	1.0	0.8	0.7
Overall balance	-0.7	0.1	0.1	-0.8	-3.6	-3.2	-2.4	-1.7
Excluding revenue windfall [2]	...	-5.1	-5.1	...	...	...	...	...
Primary balance	2.2	3.2	3.1	1.8	-1.2	-0.7	0.1	0.7
Public debt	31.7	30.5	28.7	26.2	26.8	28.9	28.8	28.3
Memorandum items:								
Revenue windfall [2]	...	5.2	5.2	...	...	...	...	...
Extrabudgetary spending	0.4	0.8	0.5	0.3	0.2	0.2	0.2	0.2
Nominal GDP (N$ billions)	39,496	42,587	43,403	47,840	52,288	56,542	61,375	66,622

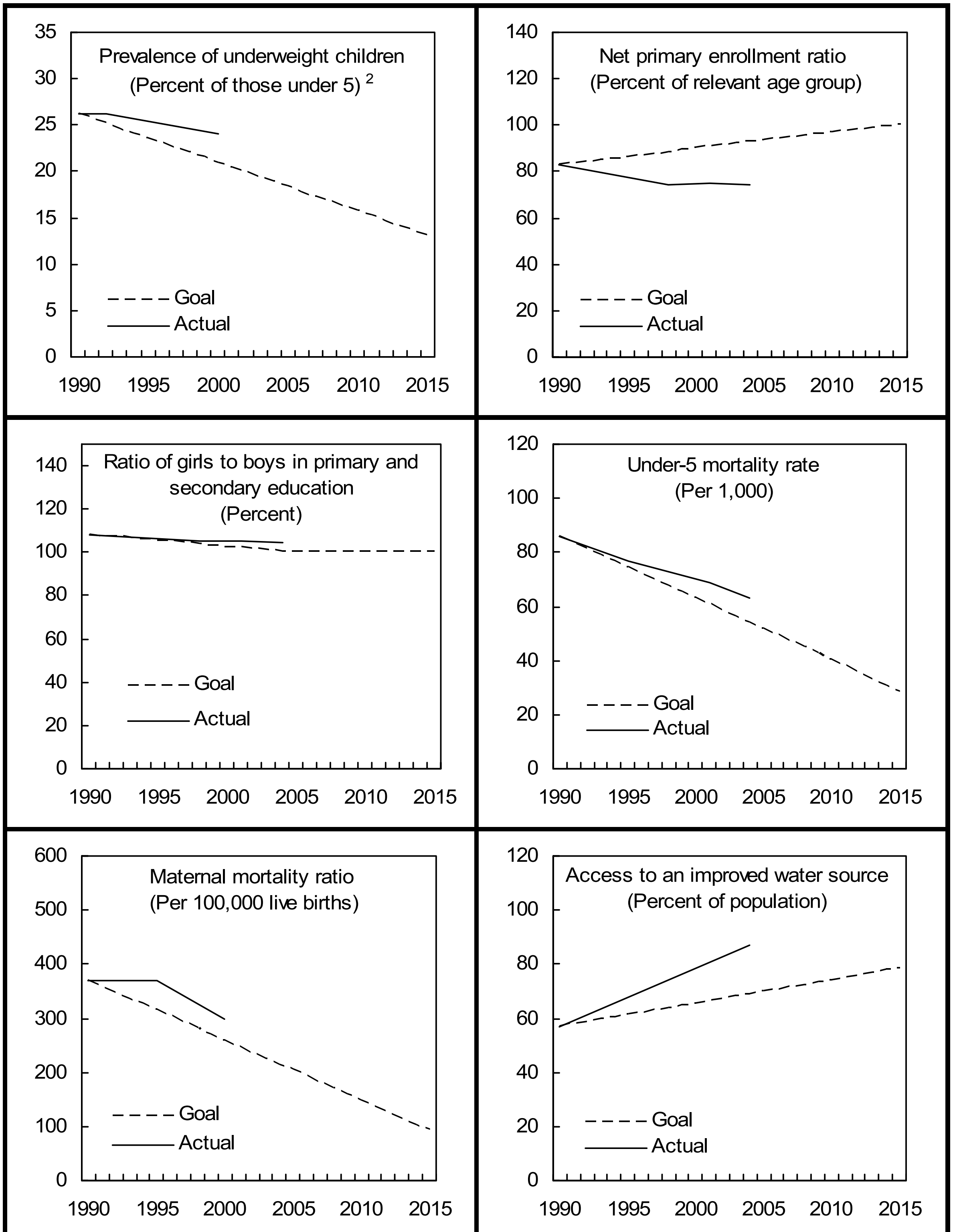
[1] In Fund staff definition, which places extrabudgetary spending financed by external loans under expenditure and the overall balance. The authorities exclude this figure in their budget presentation.

[2] The revenue windfall is estimated as the difference (as a percent of GDP) between the projected value for 2006 and the trend for 2000-05.

15. **While recognizing the medium-term fiscal pressures, the authorities do not yet have a strategy to address them**. Considering Namibia's macroeconomic circumstances, the mission recommended that the authorities aim to keep public debt on a downward trajectory, by running primary surpluses in most years. This would require adopting an effective medium-term strategy to improve revenue collections in a sustainable manner and reorient spending away from personnel expenditures and subsidies to parastatals toward priority sectors. Small primary surpluses would be consistent with preserving macroeconomic stability while allowing Namibia to address its development needs and make faster progress toward achieving the Millennium Development Goals, MDGs (Figure 6). There is also room to improve the efficiency of public expenditure, such as for education where outcomes have been below expectations and given impetus to education reform.

16. **Regarding revenues, the authorities pointed to strong increases in income and VAT collections which they attributed to having outsourced audits to the private sector**. The mission welcomed the increased collections and urged the authorities to develop a comprehensive strategy to durably enhance tax administration, as Fund TA has recommended. The strategy should include building audit capacity, establishing a large taxpayer office, and adopting a risk-based strategy for VAT refunds. The authorities reiterated their commitment to reform tax administration eventually but said they plan to rely in the short run on audit outsourcing to safeguard tax collections.

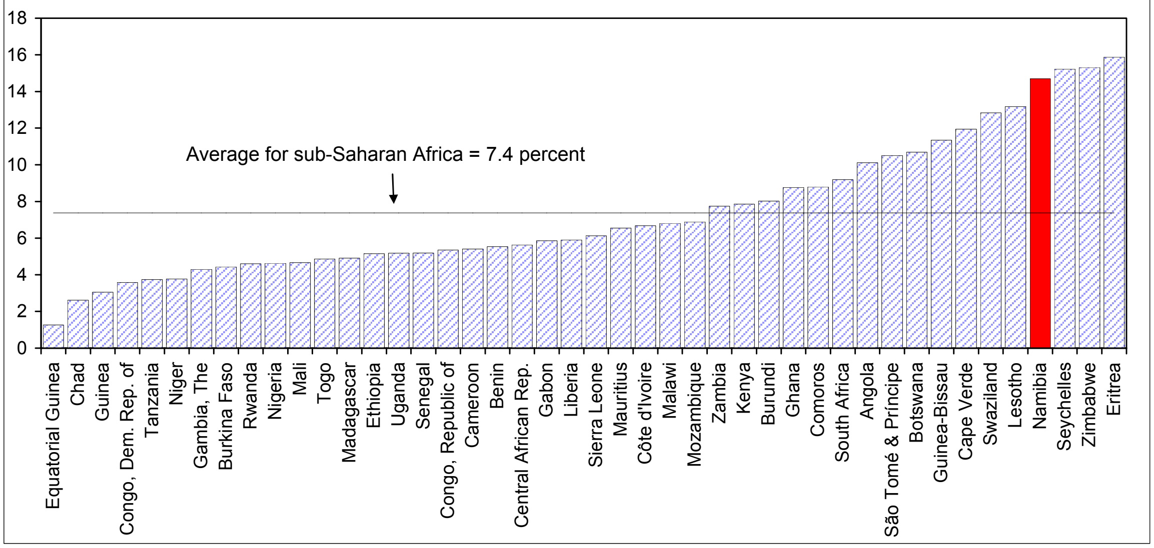
Figure 6. Namibia: Progress Toward Selected Millennium Development Goals[1]



Sources: World Bank, http://www.developmentgoals.org; and United Nations, http://unstats.un.org.
[1] Progress is measured against a linear projection between the 1990 level and the MDG.
[2] Due to lack of data, actual data for 1990 is assumed to be for 1992.

17. **Past efforts to contain the wage bill have been ineffective**. Namibia has one of the highest levels of personnel expenditure in Africa, accounting for 15 percent of GDP and two-fifths of all government spending. Due to ineffective controls,[3] line ministries have been able to circumvent a hiring freeze, leading to an 8 percent increase in the number of civil servants in 2005/06 and a doubling since independence in 1990.

Text Figure 3. Namibia and Sub-Saharan Africa: Central Government Wage Bill, 2004
(Percent of GDP)



18. **The mission strongly recommended that the authorities draw up a strategy for the appropriate structure, quality, and remuneration of the civil service**. The strategy should reduce staff through attrition, eliminate redundant government functions, and identify staffing needs and reallocate staff among ministries. Staff also recommended that growth of personnel expenditures be limited to the inflation rate.

19. **The authorities, while recognizing that the wage bill is unsustainable, consider civil service reform politically difficult, given the country's high unemployment rate and narrow economic base**. They stressed that creating private sector jobs would allow a decline in the number of civil servants in the long run.

20. **On the other hand, the authorities stressed their determination to reform state-owned enterprises (SOEs) and reduce their drain on the budget**. The recently-adopted SOE Governance Act, if implemented successfully, could lay the foundation for enhancing the government's ability to monitor SOEs, improve their governance and performance, and lessen the need for subsidies which have averaged 2 percent of GDP for the last five years. Staff recommended several measures to make the legislation an effective tool. These included recommendations that: (i) the new Governance Council focus on a broad strategic

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[3] The introduction of a real-time expenditure tracking system in 2006/07 should significantly enhance expenditure control and limit the scope for unauthorized spending.

vision, delegating operational functions to a new agency; (ii) boards of directors be selected through a transparent process; and (iii) SOEs and private firms operate on a level playing field.

21. **The mission held discussions with the authorities, as well as with a coalition of NGOs and church leaders, over efforts to reduce poverty**. The authorities agreed with the mission that more determined efforts are needed to reduce poverty but that any such efforts should not compromise fiscal stability. In a meeting with the coalition on their proposal for a basic income grant (BIG)—a cash grant to be paid to all Namibians under the age of 60 irrespective of income—the mission agreed on the importance of addressing Namibia's widespread poverty. The coalition criticized the staff's concerns in last year's staff report on the BIG's affordability, which in their view had hampered their efforts to advance the proposal. The mission accepted the coalition's view that the BIG's gross costs could be lowered on a net basis through income tax payments by high-income earners. Nonetheless, it reiterated that the BIG's net costs would remain substantial and difficult to accommodate within a sustainable fiscal framework, given other public spending priorities (including health and education). It pointed to alternative conditional cash grant schemes being implemented, quite effectively and at lower cost, in Latin America which could serve as an example for Namibia.[4]

III. Staff Appraisal

22. **With its generally prudent macroeconomic policies, Namibia has enjoyed macroeconomic stability but also faces many economic and social challenges**. These include high rates of poverty, unemployment, and HIV/AIDS infection. In the long run, raising Namibia's growth potential and safeguarding its external competitiveness will be key to addressing these challenges. This can best be achieved by creating an environment conducive to private sector activity and implementing measures aimed at a more efficient use of public resources, complemented by policies to protect the most vulnerable members of society.

23. **Recent reforms bode well for addressing these challenges, but more needs to be done to enable the private sector to be the engine of growth**. The launching of education reform, the strong implementation of the HIV/AIDS strategy, the creation of the Anti-Corruption Commission, adoption of the SOE Governance Act, and the ongoing consultations on a financial sector charter are commendable first steps. More efforts are needed to facilitate skills transfer from abroad, ensure that labor markets are flexible and less costly, expedite the licensing and registration of businesses, and further strengthen the regulatory and supervisory framework for the financial sector, especially NBFIs.

24. **At the same time, Namibia should preserve its strong record of macroeconomic stability**. This record has been based on overall prudent fiscal policies and a credible link of the Namibia dollar to the South African rand. Nonetheless, the authorities should consider

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[4] IMF Country Report No. 06/153, Chapter II, discusses the BIG and alternative conditional cash grant schemes.

market-based measures to boost international reserves while resisting regulatory means to keep Namibia's large savings at home.

25. **Recent progress in fiscal consolidation is welcome, but medium-term fiscal pressures will make it hard to keep public debt on a downward trajectory**. Without determined efforts to shore up revenues and reduce personnel expenditures and subsidies to parastatals, the government will be hard pressed to address Namibia's development needs. To sustain tax collections, the government should strengthen its audit capacity, establish a large taxpayer office, and better administer the VAT. Faced with declining SACU receipts and other expenditure demands, it will be crucial to develop a strategy to reform and reduce the size of the civil service. While the new SOE Governance Act could enhance the government's handle on the parastatals sector and limit its drain on the budget, the government should develop a strategic vision for the sector, which may include restructuring and privatizing selected SOEs. This would ensure a more efficient use of scarce public resources and foster growth.

26. Staff recommends that Namibia remain on the standard 12-month consultation cycle.

Table 1. Namibia: Selected Financial and Economic Indicators, 2003-11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.	Projections				
	(Annual percent change, unless otherwise noted)								
National income and prices									
GDP at constant 1995 prices	3.5	6.6	4.2	4.6	4.8	4.6	3.7	3.8	4.0
GDP deflator	-0.6	0.3	2.3	4.9	5.3	4.9	4.2	4.3	5.1
GDP at current market prices (N$ millions)	33,842	36,181	38,560	42,303	46,702	51,252	55,397	59,976	65,574
GDP per capita (US$)	2,253	2,792	2,984	3,157	3,373	3,611	3,778	3,958	4,188
Consumer price index (period average)	7.2	4.1	2.3	5.0	5.6	5.0	4.5	4.5	4.5
Consumer price index (end of period)	2.6	4.3	3.5	5.7	5.5	4.5	4.5	4.5	4.5
External sector									
Exports (US$)	16.6	45.8	13.3	17.1	6.1	2.2	-5.5	-4.9	2.5
Imports (US$)	33.7	23.1	10.7	9.7	8.7	7.0	5.4	3.9	0.2
Export volume	6.3	27.4	-1.5	6.1	7.6	5.9	-3.9	-4.4	-2.2
Import volume	5.2	6.6	4.6	4.8	5.0	4.8	3.8	3.9	1.6
Terms of trade	-13.6	-1.0	8.7	5.4	-4.9	-5.5	-3.2	-0.5	6.3
Real effective exchange rate (period average)	20.0	7.0	0.7	…	…	…	…	…	…
Central government finance [1]									
Revenue and grants	-6.8	16.7	14.4	20.0	6.1	-1.9	8.1	8.5	8.6
Expenditure and net lending	6.6	2.5	5.4	17.0	9.0	7.0	6.7	5.9	6.6
Money and credit									
Credit to the private sector	12.4	19.4	20.1	18.0	17.1	16.2	15.3	14.4	13.5
Broad money	9.6	16.2	9.7	20.0	19.2	18.6	18.3	17.9	16.5
	(Percent of GDP, unless otherwise noted)								
Investment and savings									
Gross investment	29.8	26.4	28.3	29.5	30.4	31.0	31.4	31.6	31.9
Public	7.0	7.4	7.5	8.5	9.0	9.2	9.4	9.4	9.4
Private	22.8	19.0	20.8	21.0	21.4	21.8	22.0	22.2	22.5
Gross domestic savings	23.2	22.3	24.7	28.4	28.7	28.2	25.5	23.9	26.0
Gross national savings	34.9	35.9	35.5	43.4	43.4	39.3	35.6	33.6	35.3
Public	-0.7	1.0	3.2	5.6	5.5	3.1	2.7	3.3	3.8
Private	35.6	34.9	32.3	37.8	37.9	36.3	32.9	30.3	31.4
Central government finance [1]									
Revenue and grants	28.3	31.0	33.0	36.0	34.7	31.1	31.1	31.1	31.1
Of which : SACU receipts	8.8	11.4	9.9	14.9	12.9	8.6	8.2	7.8	7.4
Expenditure and net lending	35.8	34.4	33.7	35.9	35.5	34.8	34.3	33.5	32.8
Of which : personnel expenditure	14.9	14.8	14.9	15.0	15.1	14.9	14.7	14.4	14.2
capital expenditure and net lending	5.7	5.3	4.3	6.1	6.1	6.0	6.0	5.8	5.7
Primary balance (- deficit)	-5.0	-0.7	2.2	3.1	1.8	-1.2	-0.7	0.1	0.7
Overall government deficit including grants	-7.5	-3.4	-0.7	0.1	-0.8	-3.6	-3.2	-2.4	-1.7
Public and publicly guaranteed debt outstanding/GDP	39.6	40.8	40.6	37.3	34.5	34.8	36.5	36.0	35.1
Public debt outstanding/GDP	29.7	34.2	31.7	28.7	26.2	26.8	28.9	28.8	28.3
External sector									
Current account balance									
Including official transfers	5.1	9.5	7.2	13.9	13.0	8.4	4.3	2.0	3.4
Excluding official transfers	-4.7	-2.0	-3.6	-0.1	-0.6	-1.7	-4.6	-6.5	-4.6
Gross official reserves									
Millions of U.S. dollars	318.9	352.7	315.9	395.6	461.9	475.8	520.5	550.2	604.2
Months of imports of goods and services	2.0	1.7	1.4	1.6	1.7	1.7	1.7	1.8	1.9
External debt/GDP (percent)	23.0	21.2	20.9	20.8	20.0	19.6	19.6	19.9	19.7
Exchange rate (Namibia dollar/U.S. dollar, end of period)	6.6	5.6	6.3	…	…	…	…	…	…
Exchange rate (Namibia dollar/U.S. dollar, period average)	7.6	6.4	6.4	…	…	…	…	…	…

Sources: Namibian authorities; and Fund staff estimates and projections.

[1] Figures are for the fiscal year, which begins April 1.

Table 2. Namibia: Balance of Payments, 2003-11

(Millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009	2010	2011[1]
				Est.	Projections				
Current account	227.1	533.3	433.6	900.7	906.7	631.0	338.8	168.8	303.4
Goods	-460.2	-283.6	-265.3	-138.7	-216.1	-353.5	-658.3	-903.4	-851.3
Exports, f.o.b.	1250.9	1823.4	2066.6	2420.1	2566.6	2623.7	2479.0	2356.6	2416.3
Of which : diamonds	510.9	824.5	848.3	962.2	1046.6	1168.3	1049.6	910.9	815.3
other minerals	182.6	227.5	275.0	426.4	462.3	392.2	350.8	321.5	304.3
fish	229.5	178.7	155.9	189.8	189.8	190.5	189.6	191.4	194.2
Imports, f.o.b. (excluding duty)	-1711.1	-2107.0	-2332.0	-2558.8	-2782.7	-2977.2	-3137.4	-3260.1	-3267.5
Of which : oil imports	-220.4	-277.2	-413.6	-545.7	-609.0	-616.4	-607.0	-600.2	-598.3
Services	165.4	54.9	43.2	69.6	102.0	144.9	194.1	252.2	323.0
Transportation	-6.6	-109.9	-107.8	-118.3	-128.7	-137.7	-145.1	-150.7	-151.1
Travel	256.7	281.4	239.7	278.7	323.2	377.8	436.4	502.2	575.5
Other services	-84.7	-116.6	-88.6	-90.7	-92.6	-95.2	-97.2	-99.3	-101.4
Income	63.6	94.7	-14.1	64.1	71.8	83.7	99.9	106.7	116.4
Compensation of employees	-4.1	-4.2	-3.6	-3.9	-4.1	-4.4	-4.7	-4.9	-5.2
Investment income	67.7	98.9	-10.5	67.9	75.9	88.1	104.5	111.6	121.6
Current transfers	458.3	667.3	669.9	905.7	948.9	755.9	703.2	713.4	715.3
Of which : SACU receipts [2]	386.8	606.8	650.1	890.4	930.8	720.4	659.5	664.4	668.7
Capital and financial account	-278.4	-604.1	-455.7	-900.7	-906.7	-631.0	-338.8	-168.8	-303.4
Capital account	67.4	77.2	79.4	74.7	77.1	77.0	76.3	76.8	76.7
Financial account	-345.8	-681.3	-535.0	-975.3	-983.7	-708.1	-415.1	-245.6	-380.1
(Excluding reserve assets)	-362.0	-647.9	-572.6	-946.9	-918.3	-691.5	-370.5	-213.4	-326.1
Direct investment	159.1	248.4	360.4	386.1	436.3	567.8	699.0	737.7	585.6
Portfolio investment	-632.3	-842.0	-1045.7	-1465.7	-1462.1	-1385.4	-1210.3	-1113.0	-1057.5
Other investment	111.2	-54.3	112.7	132.7	107.4	126.1	140.8	161.9	145.8
Reserve assets (net)	16.2	-33.4	37.5	-28.4	-65.4	-16.5	-44.6	-32.2	-54.0
Net errors and omissions	51.3	70.8	22.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Trade balance/GDP	-10.3	-5.1	-4.4	-2.1	-3.1	-4.7	-8.3	-10.8	-9.5
Current account/GDP									
Including transfers	5.1	9.5	7.2	13.9	13.0	8.4	4.3	2.0	3.4
Excluding transfers	-4.7	-2.0	-3.6	-0.1	-0.6	-1.7	-4.6	-6.5	-4.6
Exports of GNFS	1662.4	2297.5	2477.5	2875.2	3072.2	3189.6	3107.8	3055.2	3191.7
Exports/GDP (percent)	37.2	41.0	40.9	44.5	44.1	42.4	39.2	36.5	35.7
Imports of GNFS	1957.2	2526.2	2699.6	2944.2	3186.2	3398.2	3572.0	3706.5	3720.0
Imports/GDP (percent)	43.8	45.0	44.5	45.5	45.7	45.2	45.0	44.2	41.6
Gross International reserves (end of period) [3]	318.9	352.7	315.9	395.6	461.9	475.8	520.5	550.2	604.2
Months of imports of goods and services	2.0	1.7	1.4	1.6	1.7	1.7	1.7	1.8	1.9
Ratio of reserves/short-term debt	0.5	0.5	0.6	0.7	0.8	0.7	0.8	0.8	0.8
Short-term debt (US$ millions)	594.9	685.3	541.7	547.3	564.8	657.2	689.2	728.4	776.7
External debt/GDP (percent)	23.0	21.2	20.9	20.8	20.0	19.6	19.6	19.9	19.7
External debt (US$ millions) from IIP	1028.2	1191.3	1267.5	1342.0	1395.8	1471.8	1558.5	1667.3	1760.4
Exchange rate (Namibia dollar/U.S. dollar, end of period)	6.6	5.6	6.3	...	...	...	...	...	...
Exchange rate (Namibia dollar/U.S. dollar, period average)	7.6	6.4	6.4	...	...	...	...	...	...
GDP at market prices (US$ millions)	4473.7	5609.5	6060.7	6465.0	6965.3	7518.6	7932.3	8380.0	8939.3

Sources: Namibian authorities; and Fund staff estimates and projections.

[1] Namibia will become a net exporter of electricity in 2011, when electricity production related to the Kudu gas project is expected to be fully operational.

[2] Southern African Customs Union.

[3] Gross foreign assets of the Bank of Namibia, converted to U.S. dollars.

Table 3. Namibia: Central Government Operations, 2004/05-2011/12

(Millions of Namibia dollars)

	2004/05	2005/06		2006/07			2007/08	2008/09	2009/10	2010/11	2011/12
		Budget	Est.	Budget	Revised Budget	Proj.	Projections				
Revenue and grants	11,387.8	12,324.5	13,028.0	15,243.8	15,459.6	15,634.6	16,586.7	16,272.8	17,591.2	19,089.3	20,722.3
Revenue	11,317.3	12,171.3	13,028.0	15,171.8	15,387.6	15,562.6	16,507.4	16,186.1	17,497.4	18,987.5	20,611.8
Tax revenue	10,358.0	11,196.5	11,886.0	14,104.5	14,422.6	14,597.6	15,312.1	14,701.0	15,872.7	17,219.2	18,684.9
Personal income tax	2,661.9	3,165.7	2,905.0	3,286.0	3,286.0	3,286.0	3,669.7	4,089.4	4,478.6	4,953.6	5,477.0
Corporate income tax	1,222.2	1,117.3	1,573.0	1,302.0	1,302.0	1,302.0	1,530.7	1,751.5	1,972.3	2,193.2	2,434.2
Diamond mining	301.4	48.3	199.0	45.0	45.0	45.0	123.0	123.0	123.0	123.0	123.0
Other mining	7.9	6.5	1.0	7.0	7.0	7.0	7.7	8.5	9.3	10.2	11.2
Nonmining	912.9	1,062.5	1,373.0	1,250.0	1,250.0	1,250.0	1,400.0	1,620.0	1,840.0	2,060.0	2,300.0
VAT and sales taxes	1,827.8	2,820.0	3,108.0	2,925.0	2,925.0	3,100.0	3,464.7	3,839.2	4,208.0	4,659.8	5,158.1
International taxes (includes SACU receipts)	4,206.8	3,728.8	3,892.0	6,149.6	6,471.4	6,471.4	6,164.0	4,493.0	4,643.0	4,793.0	4,943.0
Other	439.4	364.7	408.0	441.9	438.2	438.2	483.0	527.9	570.8	619.6	672.6
Nontax revenue	959.3	974.8	1,142.0	1,067.3	965.0	965.0	1,195.3	1,485.1	1,624.7	1,768.3	1,926.9
Diamond royalties	385.4	242.1	405.0	316.4	258.3	258.3	397.9	592.1	634.2	697.6	767.4
Administrative fees, including license revenues	348.8	402.1	511.0	419.5	419.0	419.0	461.8	504.8	545.9	592.5	643.2
Other	225.1	330.6	226.0	331.4	287.7	287.7	335.5	388.2	444.6	478.1	516.3
Grants (tied)	70.4	153.2	0.0	72.0	72.0	72.0	79.4	86.7	93.8	101.8	110.5
Expenditures	12,640.3	12,949.0	13,317.7	15,300.4	15,400.8	15,580.3	16,980.4	18,171.4	19,382.4	20,533.9	21,884.6
Current expenditure	10,684.1	11,069.7	11,618.0	12,364.4	12,497.9	12,935.7	14,065.5	15,011.6	15,993.8	16,978.4	18,091.8
Personnel	5,445.8	5,534.1	5,888.4	6,129.7	6,139.4	6,500.0	7,212.2	7,778.4	8,298.0	8,823.3	9,444.3
Goods and services	1,957.1	1,946.4	2,022.2	2,292.2	2,323.0	2,323.0	2,555.1	2,738.2	2,877.0	3,034.6	3,199.9
Interest payments	999.2	1,109.9	1,162.0	1,312.7	1,312.7	1,312.7	1,259.8	1,252.6	1,397.3	1,498.6	1,615.9
Domestic	930.2	1,037.2	1,080.0	1,215.3	1,215.3	1,215.3	1,149.4	1,135.0	1,272.8	1,369.3	1,481.3
Foreign	69.0	72.7	82.0	97.5	97.5	97.5	110.3	117.6	124.5	129.3	134.6
Subsidies and current transfers	2,282.0	2,479.3	2,545.4	2,629.8	2,722.8	2,800.0	3,038.4	3,242.5	3,421.4	3,621.9	3,831.6
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	1,627.1	1,701.7	1,524.2	2,317.5	2,316.5	2,058.2	2,316.4	2,584.1	2,850.9	3,094.6	3,359.2
Acquisition of capital assets	1,421.4	1,568.5	1,463.2	2,069.1	2,068.1	1,809.8	2,042.6	2,284.9	2,527.3	2,743.3	2,977.8
Capital transfers	205.7	133.2	61.0	248.4	248.4	248.4	273.8	299.3	323.6	351.3	381.3
Net lending	329.1	177.6	175.5	618.5	586.4	586.4	598.5	575.7	537.7	460.9	433.7
Overall balance [1]	-1,252.6	-624.6	-289.7	-56.6	58.8	54.3	-393.7	-1,898.6	-1,791.2	-1,444.6	-1,162.3
Overall balance excluding extrabudgetary spending [1]	-1,027.0	-380.9	-143.5	287.9	403.3	261.0	-235.1	-1,797.6	-1,682.0	-1,326.0	-1,033.6
Primary balance	-253.4	485.3	872.3	1,256.1	1,371.5	1,367.0	866.1	-646.0	-393.9	54.0	453.6
Statistical discrepancy	199.6	0.0	-76.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	1,452.2	624.6	213.1	56.6	-58.8	-54.3	393.7	1,898.6	1,791.2	1,444.6	1,162.3
Domestic	1,254.0	414.9	100.9	-253.9	-1,052.7	-910.4	269.1	1,834.8	1,722.1	1,369.6	1,080.0
Central bank	-682.8	…	-46.0	…	…	-669.9	400.0	582.0	-400.0	250.0	150.0
Commercial banks	517.8	…	481.6	…	…	-288.0	-100.0	310.0	570.0	330.0	230.0
Nonbank	1,419.0	…	-334.8	…	…	47.5	-30.9	942.8	1,552.1	789.6	700.0
External	198.2	209.7	112.2	310.5	310.5	172.7	124.5	63.8	69.0	74.9	82.3
Disbursements	225.5	243.7	146.2	344.5	344.5	206.7	158.5	101.0	109.2	118.6	129.7
Amortization	-27.4	-34.0	-34.0	-34.0	-34.0	-34.0	-34.0	-37.2	-40.2	-43.6	-47.3
Privatization	…	…	…	…	683.5	683.5	…	…	…	…	…
Memorandum items:											
Public and publicly guaranteed debt	14,996.7	…	16,037.9	…	…	16,196.3	16,509.3	18,180.9	20,614.6	22,080.4	23,365.2
Public debt	12,559.0	…	12,533.1	…	…	12,475.0	12,551.1	14,011.5	16,332.2	17,677.4	18,852.3
Domestic	10,543.0	…	10,689.8	…	…	10,449.3	10,318.4	11,571.2	13,693.3	14,813.0	15,743.0
External	2,016.0	…	1,843.3	…	…	2,025.7	2,232.7	2,440.3	2,638.8	2,864.4	3,109.3
Publicly guaranteed debt	2,437.7	…	3,504.8	…	…	3,721.3	3,958.2	4,169.4	4,282.4	4,403.0	4,512.9
GDP at current market prices (N$ millions)	36,776	39,503	39,496	42,587	42,587	43,403	47,840	52,288	56,542	61,375	66,622

Sources: Namibian authorities; and Fund staff estimates and projections.

[1] "Overall balance" reflects externally financed project spending (except for roads) that is not channeled through the state account. "Overall balance excluding extrabudgetary spending" excludes such spending and thus corresponds directly with the authorities' concept.

Table 3. Namibia: Central Government Operations, 2004/05-2011/12 (continued)

(Percent of GDP)

	2004/05	2005/06		2006/07			2007/08	2008/09	2009/10	2010/11	2011/12
		Budget	Est.	Budget	Revised Budget	Proj.	Projections				
Revenue and grants	31.0	31.2	33.0	35.8	36.3	36.0	34.7	31.1	31.1	31.1	31.1
Revenue	30.8	30.8	33.0	35.6	36.1	35.9	34.5	31.0	30.9	30.9	30.9
Tax revenue	28.2	28.3	30.1	33.1	33.9	33.6	32.0	28.1	28.1	28.1	28.0
Personal income tax	7.2	8.0	7.4	7.7	7.7	7.6	7.7	7.8	7.9	8.1	8.2
Corporate income tax	3.3	2.8	4.0	3.1	3.1	3.0	3.2	3.3	3.5	3.6	3.7
Diamond mining	0.8	0.1	0.5	0.1	0.1	0.1	0.3	0.2	0.2	0.2	0.2
Other mining	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonmining	2.5	2.7	3.5	2.9	2.9	2.9	2.9	3.1	3.3	3.4	3.5
VAT and sales taxes	5.0	7.1	7.9	6.9	6.9	7.1	7.2	7.3	7.4	7.6	7.7
International taxes (includes SACU receipts)	11.4	9.4	9.9	14.4	15.2	14.9	12.9	8.6	8.2	7.8	7.4
Other	1.2	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nontax revenue	2.6	2.5	2.9	2.5	2.3	2.2	2.5	2.8	2.9	2.9	2.9
Diamond royalties	1.0	0.6	1.0	0.7	0.6	0.6	0.8	1.1	1.1	1.1	1.2
Administrative fees, including license revenues	0.9	1.0	1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other	0.6	0.8	0.6	0.8	0.7	0.7	0.7	0.7	0.8	0.8	0.8
Grants (tied)	0.2	0.4	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Expenditures	34.4	32.8	33.7	35.9	36.2	35.9	35.5	34.8	34.3	33.5	32.8
Current expenditure	29.1	28.0	29.4	29.0	29.3	29.8	29.4	28.7	28.3	27.7	27.2
Personnel	14.8	14.0	14.9	14.4	14.4	15.0	15.1	14.9	14.7	14.4	14.2
Goods and services	5.3	4.9	5.1	5.4	5.5	5.4	5.3	5.2	5.1	4.9	4.8
Interest payments	2.7	2.8	2.9	3.1	3.1	3.0	2.6	2.4	2.5	2.4	2.4
Domestic	2.5	2.6	2.7	2.9	2.9	2.8	2.4	2.2	2.3	2.2	2.2
Foreign	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Subsidies and current transfers	6.2	6.3	6.4	6.2	6.4	6.5	6.4	6.2	6.1	5.9	5.8
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	4.4	4.3	3.9	5.4	5.4	4.7	4.8	4.9	5.0	5.0	5.0
Acquisition of capital assets	3.9	4.0	3.7	4.9	4.9	4.2	4.3	4.4	4.5	4.5	4.5
Capital transfers	0.6	0.3	0.2	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Net lending	0.9	0.4	0.4	1.5	1.4	1.4	1.3	1.1	1.0	0.8	0.7
Overall balance [1]	-3.4	-1.6	-0.7	-0.1	0.1	0.1	-0.8	-3.6	-3.2	-2.4	-1.7
Overall balance excluding extrabudgetary spending [1]	-2.8	-1.0	-0.4	0.7	0.9	0.6	-0.5	-3.4	-3.0	-2.2	-1.6
Primary balance	-0.7	1.2	2.2	2.9	3.2	3.1	1.8	-1.2	-0.7	0.1	0.7
Statistical discrepancy	0.5	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	3.9	1.6	0.5	0.1	-0.1	-0.1	0.8	3.6	3.2	2.4	1.7
Domestic	3.4	1.1	0.3	-0.6	-2.5	-2.1	0.6	3.5	3.0	2.2	1.6
Central bank	-1.9	…	-0.1	…	…	-1.5	0.8	1.1	-0.7	0.4	0.2
Commercial banks	1.4		1.2	…	…	-0.7	-0.2	0.6	1.0	0.5	0.3
Nonbank	3.9	…	-0.8	…	…	0.1	-0.1	1.8	2.7	1.3	1.1
External	0.5	0.5	0.3	0.7	0.7	0.4	0.3	0.1	0.1	0.1	0.1
Disbursements	0.6	0.6	0.4	0.8	0.8	0.5	0.3	0.2	0.2	0.2	0.2
Amortization	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Privatization	…	…	…	…	1.6	1.6	…	…	…	…	…
Memorandum items:											
Public and publicly guaranteed debt	40.8	…	40.6	…	…	37.3	34.5	34.8	36.5	36.0	35.1
Public debt	34.2	…	31.7	…	…	28.7	26.2	26.8	28.9	28.8	28.3
Domestic	28.7	…	27.1	…	…	24.1	21.6	22.1	24.2	24.1	23.6
External	5.5	…	4.7	…	…	4.7	4.7	4.7	4.7	4.7	4.7
Publicly guaranteed debt	6.6	…	8.9	…	…	8.6	8.3	8.0	7.6	7.2	6.8
GDP at current market prices (N$ millions)	36,776	39,503	39,496	42,587	42,587	43,403	47,840	52,288	56,542	61,375	66,622

Sources: Namibian authorities; and Fund staff estimates and projections.

[1] "Overall balance" reflects externally financed project spending (except for roads) that is not channeled through the state account. "Overall balance excluding extrabudgetary spending" excludes such spending and thus corresponds directly with the authorities' concept.

Table 4. Namibia: Monetary Developments, 2003-11 [1]

(Millions of Namibia dollars, end of period)

	2003 Dec.	2004 Dec.	2005 Dec.	2006 Mar.	2006 Jun.	2006 Sep.	2006 Dec. Est.	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec.	2011 Dec.
								Projections				
Bank of Namibia												
Reserve money	1,172.9	1,238.6	1,372.5	1,270.0	1,330.3	1,458.9	1,590.8	1,853.8	2,165.8	2,524.7	2,934.2	3,370.7
Currency	918.9	945.8	1,026.8	922.8	976.4	1,041.3	1,193.1	1,371.8	1,581.1	1,817.8	2,083.3	2,359.5
Reserves	254.0	292.9	345.7	347.2	353.7	417.6	397.7	482.0	584.8	706.9	850.9	1,011.2
Net foreign assets	2,110.3	1,977.3	1,983.9	2,457.7	2,677.9	3,119.2	2,312.9	2,708.9	2,961.8	3,272.2	3,672.2	4,072.2
Net domestic assets	-937.4	-738.7	-611.4	-1,187.7	-1,347.6	-1,660.3	-722.1	-855.1	-796.0	-747.5	-738.0	-701.5
Domestic credit	-315.7	-637.4	-79.5	-647.9	-501.4	-652.4	-854.8	-722.3	-185.8	-340.3	-252.8	-77.8
Banks	95.3	238.7	515.2	181.6	833.1	1,099.2	515.2	515.2	515.2	515.2	515.2	515.2
Government (net)	-430.1	-889.7	-608.1	-843.1	-1,348.2	-1,766.1	-1,383.4	-1,250.9	-714.4	-868.9	-781.4	-606.4
Of which : State Accounts [2]	-251.7	-719.0	-454.2	-781.0	-1,276.9	-1,690.3	-1,283.4	-1,150.9	-614.4	-768.9	-681.4	-506.4
Other sectors	19.0	13.6	13.4	13.6	13.7	14.5	13.4	13.4	13.4	13.4	13.4	13.4
Other items net	-621.7	-101.3	-531.9	-539.8	-846.2	-1,007.9	132.7	-132.8	-610.2	-407.2	-485.2	-623.7
Monetary survey												
Broad money	13626.7	15828.9	17370.2	18754.2	20546.0	21511.9	20,839.1	24,841.5	29,455.3	34,840.9	41,079.3	47,864.5
Currency	584.6	632.7	680.0	681.0	726.7	785.6	839.8	993.7	1,160.5	1,358.8	1,437.8	1,675.3
Deposits	13,042.1	15,196.2	16,690.2	18,061.8	19,809.8	20,720.4	19,999.3	23,847.8	28,294.7	33,482.1	39,641.6	46,189.2
Net foreign assets	1,259.6	970.3	-156.3	723.3	1,496.2	3,944.3	1,337.2	1,178.2	1,019.2	860.3	701.3	542.3
Net domestic assets	12,367.0	14,858.6	17,526.5	18,030.9	19,049.8	17,567.6	19,501.9	23,663.2	28,436.0	33,980.7	40,378.1	47,322.2
Domestic credit	17,346.6	21,169.4	25,670.1	26,543.4	27,672.3	27,940.1	28,912.8	33,725.4	39,824.4	46,051.7	52,906.6	60,176.3
Private sector	16,676.3	19,918.7	23,922.4	24,748.2	25,803.0	26,789.2	28,228.4	33,055.5	38,410.5	44,287.3	50,664.7	57,504.4
Government (net)	506.7	871.7	1,405.7	1,088.2	608.4	183.6	342.4	327.9	1,071.9	1,422.4	1,899.9	2,329.9
Others [3]	163.6	379.0	342.0	707.1	1,260.9	967.3	342.0	342.0	342.0	342.0	342.0	342.0
Other items net	-4,979.5	-6,310.8	-8,143.6	-8,512.5	-8,622.5	-10,372.5	-9,410.9	-10,062.2	-11,388.4	-12,071.0	-12,528.5	-12,854.1
Memorandum items:												
Annual percent change												
Reserve money	19.6	5.6	10.8	4.7	8.0	8.9	15.9	16.5	16.8	16.6	16.2	14.9
Broad money	9.6	16.2	9.7	13.7	19.5	26.1	20.0	19.2	18.6	18.3	17.9	16.5
Private sector credit	12.4	19.4	20.1	19.0	19.0	17.4	18.0	17.1	16.2	15.3	14.4	13.5
Velocity	2.5	2.4	2.3	2.4	2.3	2.2	2.0	1.9	1.7	1.6	1.5	1.4
Money multiplier	11.6	12.8	12.7	14.8	15.4	14.7	13.1	13.4	13.6	13.8	14.0	14.2
Exchange rate (Namibia dollar/U.S. dollar)	6.6	5.6	6.3	6.2	7.2	7.8	…	…	…	…	…	…
Net foreign assets (US$ millions)	189.7	172.3	-24.7	116.6	208.7	508.0	197.8	177.2	145.9	123.2	95.6	73.9
Bank of Namibia	317.8	351.2	313.7	396.1	373.5	401.7	342.1	407.5	424.0	468.6	500.9	554.9
Commercial banks	-128.1	-178.9	-338.4	-279.5	-164.8	106.3	-144.3	-230.2	-278.1	-345.4	-405.2	-481.0
Domestic interest rates (end of period)												
Deposit rate	6.9	6.4	6.0	6.1	6.2	6.2	…	…	…	…	…	…
Lending rate	12.9	10.7	10.8	10.8	10.6	11.7	…	…	…	…	…	…
Bank rate [4]	7.8	7.5	7.0	7.0	7.5	8.0	…	…	…	…	…	…
3-month T-bill rate	7.4	7.5	7.0	6.7	7.1	7.9	…	…	…	…	…	…

Sources: Bank of Namibia; and Fund staff estimates and projections.

[1] The authorities are reconciling the monetary statistics. Data reconciliation is completed for March 2006 onwards and for prior to February 2006 is expected to be completed by March 2007. The main changes expected are in the classification of commercial bank assets and liabilities between resident and nonresident.

[2] These include an account for bond redemption.

[3] "Others" includes local and regional government and nonfinancial public enterprises.

[4] BoN overdraft rate.

Table 5. Namibia: Indicators of External and Financial Vulnerability, 2001-06

(Percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	Latest	Date of Latest Observation
Financial indicators							
Public sector debt of the central government [1]	25.9	23.9	29.7	34.2	31.7	31.3	Jun. 2006
Broad money (percent change, 12-month basis)	4.5	6.9	9.6	16.2	9.7	26.1	Sep. 2006
Private sector credit (percent change, 12-month basis)	16.3	20.2	12.4	19.4	20.1	17.4	Sep. 2006
Bank of Namibia overdraft interest rate (bank rate) [2]	9.3	12.8	7.8	7.5	7.0	9.0	Dec. 2006
Bank of Namibia overdraft real interest rate [2 3]	1.0	0.3	5.2	3.2	3.5	2.5	Sep. 2006
External indicators							
Exports (percent change, 12-month basis in U.S. dollars)	-13.5	-6.1	16.6	45.8	13.3	...	Dec. 2005
Imports (percent change, 12-month basis in U.S. dollars)	2.3	-4.6	33.7	23.1	10.7	...	Dec. 2005
Terms of trade (percent change, 12-month basis)	-8.0	21.6	-13.6	-1.0	8.7	...	Dec. 2005
Current account balance	1.5	4.4	5.1	9.5	7.2	...	Dec. 2005
Capital and financial account balance	4.2	-6.4	-6.2	-10.8	-7.5	...	Dec. 2005
Gross official reserves (US$ millions) [2]	224.0	336.2	318.9	352.7	315.9	452.6	Sep. 2006
Official reserves in months of imports of goods and services [2]	1.7	2.7	2.0	1.7	1.4	...	Dec. 2005
Broad money to reserves	5.2	3.5	5.6	7.0	8.6	7.0	Sep. 2006
Reserves/total short-term external debt [2]	1.5	1.1	0.5	0.5	0.6	...	Dec. 2005
Total external debt (US$ millions) [2]	596.3	585.8	1,028.2	1,191.3	1,267.5	...	Dec. 2005
Of which : public sector debt (US$ millions)	128.7	140.3	242.1	300.6	337.3	...	Dec. 2005
Total external debt to exports of goods and services [2]	41.6	43.6	61.8	51.9	51.2	...	Dec. 2005
Nominal exchange rate (Namibia dollar/U.S. dollar, period average)	8.6	10.5	7.6	6.4	6.4	6.8	Nov. 2006
Real effective exchange rate (percent change, depreciation = '-')	-5.0	-8.3	20.0	7.0	0.7	-0.5	Sep. 2006
Financial market indicators							
End-of-period stock market index	392.0	305.0	347.0	425.9	581.7	806.0	Dec 05, 2006

Sources: Namibian authorities; and Fund staff estimates.

[1] Fiscal years, which begin on April 1.

[2] End of period.

[3] Deflated by the percentage change in end-of-period CPI.

Statement by Peter Gakunu, Executive Director for Namibia
and John Steytler, Senior Advisor to Executive Director
January 5, 2007

1. The Namibian authorities are grateful to staff for their constructive dialogue and comments, as well as to the Executive Board and Management for their continued support. There is a broad measure of agreement between staff and the authorities on most aspects of economic policy.

Economic Prospects

2. **Real GDP growth is expected to increase moderately to 4.5 percent in 2006, after 4.25 percent in 2005, due in part to a recovery in diamond production**. In the medium-term, the economy is expected to expand at 3-4 percent. Despite rising oil prices, consumer price inflation increased only moderately to 5.6 percent and is expected to remain moderate at single digit level in the medium term. There has been a strong effort to consolidate the fiscal position, with the fiscal deficit falling by close to 7 percentage points during the last two fiscal years to less than one percent of GDP in 2005/06 and a small surplus in 2006/07. The external current account is expected to double to close to 14 percent of GDP in 2006, because of record diamond exports and a surge in customs union receipts. **Overall the economic fundamentals of the country remain strong**. This has been acknowledged by international credit rating agencies, which reaffirmed Namibia's sovereign credit rating at investment grade level.

Challenges and Risks

3. **This excellent performance notwithstanding, a number of challenges and risks remain.** The authorities are vigilant to these and agree with staff on the need to sustain prudent economic policies, to which they are fully committed. Some of the key challenges that the country faces going forward, include broadening the economic base and raising its long-term growth potential. In addition, poverty and unemployment remain widespread, and although significant progress was made in addressing the HIV/AIDS pandemic, high infection rates continue to undermine investment in human capital. In this regard, **the authorities would like to reiterate their call to the International Financial Institutions to revisit the classification of Namibia as a middle income country.** This classification, which relies exclusively on income per capita, while ignoring one of the most important yardsticks for development namely, income disparity, creates serious challenges in accessing concessional funding. The authorities hope that a compromised set of terms and conditions for this growing group of countries, along the lines of that for the Caribbean Island States, could be reached to help them in their endeavor to achieve the Millennium Development Goals by 2015.

Fiscal Policy

4. **During the past three years, there has been a tremendous effort on fiscal consolidation, with the fiscal position turning from a deficit of close to 7 percent of GDP in 2003/04 to a small surplus in 2006/07.** As a result, the authorities were able to reduce the public debt to GDP ratio which is projected to fall from above 30 percent of GDP in 2003/04 to around 26 percent of GDP in 2007/08, within striking distance of the authorities' fiscal rule target of 25 percent of GDP. The authorities note staff's observation that more of the SACU windfall revenue should have been devoted to debt reduction. The authorities are of the view that since they were able to reduce the public deficit significantly over a short period of time this effort should be seen as an indication of the direction of fiscal policy and their strong commitment to implementation of prudent fiscal and debt management policies. In the medium term, they are committed to achieving their debt target through further alignment of revenue and expenditure, while freeing up as much resources as possible for poverty reducing expenditure and growth critical physical infrastructure.

5. **The authorities are aware of the medium-term fiscal pressures that will come from a projected fall in SACU revenue receipts and increased social and poverty reducing expenditure outlays**. The authorities have been relatively successful in strengthening revenue collection, especially income tax and VAT collection through targeted forensic audits by private auditing firms. They realize that this strategy does not present a long-term solution and have already started to explore other alternatives to strengthen tax administration, including a Fund diagnostic mission on tax administration. Another element in the authorities' strategy for improved fiscal performance is the reform of some state owned enterprises, which currently put a heavy burden on the budget. In this regard, they are thankful for Fund TA on how to improve their ability to monitor state owned enterprises and improve their governance and performance.

6. **Reducing the size of the civil service is not an easy task in a country like Namibia**, **given the political history, the high level of unemployment and the vastness and low population density of the country.** While the authorities share staff's concern about the size of the civil service, they are of the view that a reduction of the civil service may not be possible in the short-term. Focusing on the public wage bill alone may not necessarily be the right approach to understanding fiscal sustainability in a country like Namibia. The authorities believe that, if the economy can grow at an accelerated pace, and if more private sector jobs are created, then the relative size and wage bill of the public sector will decline over time. Essentially, the authorities, therefore, view the issue of containment of the wage bill as a long-term issue. In the short run, there could even be additional upward pressure on the wage bill as the authorities expand social and poverty reducing outlays. The fact of the matter is that if an extra school or clinic is built, it requires more teachers and doctors; otherwise why build the extra school or clinic. The Namibian government believes it has the duty to provide essential poverty reducing social services to all its citizens, and given the remoteness and low population it is an expensive exercise to which the government is,

nevertheless, fully committed. However, the authorities are committed in the short-term also to clean up the wage bill in terms of possible ghost workers and over manning. Outsourcing of further services will also be pursued where possible.

7. **Reducing widespread poverty remains the key policy objective of the Namibian government**. The authorities believe that there is no easy solution to this problem and to effectively address it requires policy action on a wide range of fronts. Ultimately effective poverty reduction is possible only through accelerated growth, with redistribution policies playing a supportive role. In this connection, a key policy objective of the Namibian government is to maintain a stable macroeconomic environment, which is an essential precondition for accelerated growth, while having in place a number of social safety nets to protect the most vulnerable groups in society. Currently, the Namibian government maintains four such social safety nets, namely old age pension, pension for war veterans, support for orphans and support for people with disabilities. Payments to these groups are reviewed on a regular basis, and the authorities are committed to increase these in line with government's ability to do so as they have done in the past. It should also be noted that the Namibian government has been investing aggressively in the reduction of future poverty since independence. For instance, almost half of the budget is allocated to the health and education sectors, which is among the highest in the world. We can, thus, safely say that the Namibian budget is pro-poor. The authorities took note of the BIG coalition's call for a cash grant to be paid to all Namibians under the age of 60 years to address widespread poverty. They are encouraged that staff agree with them that efforts to reduce poverty should not compromise fiscal stability.

Monetary and Exchange Rate Policy

8. **The Namibian authorities remain fully committed to the exchange rate peg to the South African Rand and membership to the Common Monetary Area (CMA) to anchor price expectations.** As shown by recent trends in consumer price inflation, the authorities have been successful in achieving their objective of low and stable prices. The authorities take note of staff's concern about the low level of reserves, but believe that the current level of reserves does not pose a risk for the exchange rate peg, as it is more than sufficient to cover currency in circulation. The authorities, nevertheless, note staff's suggestions to build reserves, including strengthening of liquidity management to enable purchasing of foreign exchange in the market and the deepening and widening of the domestic financial markets. However, as staff stated, the authorities at this stage would like to keep all their options open and would, therefore, not want to exclude the possibility of taking regulatory steps to stem the outflow of savings. They want to reaffirm their view that it is uncharacteristic for a developing country like Namibia with large developmental needs to export some 65 percent of its savings. This situation also does not bode well for the development of domestic financial markets. Nevertheless, they would like to assure that should they decide to go ahead with the introduction of limits on capital flows, that it would

be done in a balanced manner that will safeguard the interest of pensioners, while stimulating economic growth at the same time.

Structural Issues

9. **The authorities welcomed this year's Article IV Consultations which focused on private sector development.** After having firmly achieved macroeconomic stability, the authorities would like to focus on micro reforms that could put the country on a higher plane of sustainable growth, necessary to achieve its Vision 2030 objectives. Development of the private sector will form a key component of the authorities' future plans. A number of studies, both internally and externally, have shown that a key constraint to growth in Namibia is lack of skills, compounded by the HIV/AIDS pandemic, and lack of innovation and entrepreneurship, while the institutional settings are relatively strong.

10. **The authorities are following a structural approach to addressing barriers to growth. A key element of the authorities' strategy, therefore, was to address the HIV/AIDS pandemic.** It is encouraging to note that with the help of the international community there are encouraging signs that the authorities are starting to win the battle against this dreadful disease. Nevertheless, even as infection rates are starting to level off and the coverage of antiretroviral treatment continues to expand, with universal coverage expected by 2010, the fiscal costs and pressure on the budget will remain. The authorities are aware that the economy will have to grow faster to absorb these costs and to reduce the pressure on the budget. **Another key element in the authorities' strategy that has been prioritized, is education reform, with the assistance of the World Bank.**

11. **The authorities broadly agree with staff on the need for reform in other areas**, **such as labor market reform, further modernization of the financial system, especially enhancing access to financial services for rural and low-income customers, and further strengthening of the regulatory and supervisory framework of the financial sector, especially the non-bank financial sector.** With respect to the latter, the authorities have made good progress in complying with all Basle Core Principles of Banking Supervision, while substantial progress was made on restructuring the supervisory agency for non-bank financial institutions. The authorities are grateful for Fund TA immediately following the 2005 FSAP and are fully committed to implement all recommendations of the FSAP, although there might be delays in some areas due to weak capacity.

Conclusion

12. In conclusion, the authorities would like to affirm their unwavering commitment to prudent and market friendly policies, aimed at accelerated growth, employment creation and poverty reduction. They trust that the Fund and the international community will continue to be fully responsive in providing the necessary support to enable them strengthen their macroeconomic frame work and ability to implement reforms.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Namibia

On January 5, 2007 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Namibia.[1]

Background

Growth is expected to increase to 4½ percent in 2006, after 4¼ percent in 2005, due in part to a recovery in diamond production. Rising oil prices and interest rates have not yet noticeably affected activity. Though rising, inflation is expected to remain moderate. The external current account surplus is expected to double to close to 14 percent of GDP in 2006, thanks to record diamond exports and a surge in customs union (SACU) receipts. However, continued outflows of capital to South African financial markets have kept international reserves relatively low. Consistent with the peg to the rand, the Bank of Namibia has matched recent interest rate increases by the South African Reserve Bank, lifting rates by 2 percentage points in 2006.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The fiscal deficit fell by close to 7 percentage points during the last two fiscal years, to ¾ percent of GDP in 2005/06. While windfall revenues are expected to lead to a small budget surplus in 2006/07, the underlying fiscal position is set to weaken. Namibia will receive a 5 percent of GDP windfall in SACU revenues in 2006/07, the largest portion of which will be directed towards increased expenditures. As a result of the recent fiscal consolidation, Namibia's public debt ratio is projected to come close to the authorities' fiscal rule target of 25 percent of GDP by 2007/08. Nonetheless, public debt is poised to rise again over the medium term in light of an expected decline in SACU receipts and an increase in spending to address Namibia's development needs, unless reforms are undertaken to shore up revenues and reduce non-priority spending.

Namibia faces a number of economic and social challenges over the medium term. Economic growth remains volatile and depends on mining, and Namibia also has high rates of poverty, unemployment, and HIV/AIDS infection.

Executive Board Assessment

Directors commended the authorities for following prudent macroeconomic policies that had contributed to robust growth, moderate inflation, and large external surpluses. At the same time, economic and social challenges remain, and focus needs to be placed on broadening the economic base and raising Namibia's long-term growth potential. Directors welcomed the progress made in implementing reforms to reduce poverty, unemployment, and high rates of HIV/AIDS infection. A reform of the education system has been launched, a sound HIV/AIDS strategy is in place, and an Anti-Corruption Commission has been established to promote governance and private sector development. However, additional efforts are needed to ensure an efficient and more flexible labor market and to further support the business environment.

Directors stressed the importance of prudent fiscal policies and increases in international reserves to preserve macroeconomic stability, and welcomed the fiscal consolidation efforts of the past two years. In this context, they recalled the authorities' commendable efforts to reduce public debt. However, noting the loosening of the underlying fiscal stance in 2006/07, several Directors considered that a larger part of expected revenue windfalls could have been devoted to reducing public debt, especially given the projected medium-term decline in Southern African Customs Union revenues and the future plans to increase development and pro-poor spending. Directors underlined that a poverty reduction program, if established, should be targeted and not compromise hard-won fiscal sustainability.

Directors welcomed the progress made in boosting VAT and income tax receipts through private sector-led audits, but considered that further efforts to raise revenues are needed. To sustain tax collections, VAT administration and the audit capacity of the Inland Revenue Department should be strengthened, and a large taxpayers' office established.

Directors encouraged the authorities to limit the growth of public wage expenditures and develop a strategy to determine the appropriate structure, quality, and remuneration level for the civil service. They welcomed the authorities' commitment to reform state-owned enterprises (SOEs), and urged them to take the necessary steps to make the new SOE Governance Act effective.

Directors agreed that the Namibia dollar's peg to the South African rand remains appropriate. To strengthen foreign reserves and help keep domestic savings in the country in the long term, Directors recommended developing domestic investment opportunities and market-based strategies—such as asset securitization and open market purchases of foreign exchange. Most Directors counseled against regulatory measures to stem capital outflows, although a few others considered that such measures could be useful on a short-term and temporary basis.

Directors commended the authorities for implementing recommendations of the 2005 Financial Sector Assessment Program and the progress made toward complying with the Basel Core Principles on banking system supervision. They called for a further strengthening of the financial sector's regulatory and supervisory framework, especially for nonbank financial institutions, and for continued work to extend financial services to rural areas and the poor.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Namibia: Selected Economic Indicators

	2003	2004	2005	2006 Est.
	(Percent)			
Change in real GDP	3.5	6.6	4.2	4.6
Change in CPI (end of period)	2.6	4.3	3.5	5.7
	(Percent of GDP)			
Overall fiscal deficit [1]	-7.5	-3.4	-0.7	0.1
Public debt [1]	29.7	34.2	31.7	28.7
	(End of period; percent change)			
Broad money	9.6	16.2	9.7	20.0
Credit to the private sector	12.4	19.4	20.1	18.0
	(Percent of GDP, unless stated otherwise)			
Current account balance	5.1	9.5	7.2	13.9
International reserves (months of imports)	2.0	1.7	1.4	1.6
Exchange rate (Namibia dollar/U.S. dollar, end of period)	6.6	5.6	6.3	...

Sources: Namibian authorities; and IMF staff estimates.
[1] Figures are for fiscal year, which begins April 1.